بنك إسرائيل BANK OF ISRAEL בנק ישראל

Banking Supervision Department
Policy and Regulation Division

June 21, 2021
Circular No. C-06-2662

Attn:
The Banking Corporations and Credit Card Companies

Re: Net Stable Funding Ratio

(Proper Conduct of Banking Business Directive no. 222)

Introduction

1. Pursuant to the lessons of the global financial crisis, the Basel Committee promulgated important reforms that aim to improve the resilience of the banking sector. One of these reforms, published in October 2014, is a net stable funding ratio (hereinafter: NSFR) standard. The standard creates a specific framework for the calculation of the NSFR in order to establish international uniformity. The NSFR is meant to improve the liquidity-risk resilience profile of banking corporations in the long term by requiring these corporations to maintain a stable funding profile commensurate with the composition of their balance-sheet assets and their off-balance-sheet activities. The ratio limits overreliance of banking corporations on short-term wholesale funding.
2. This Directive adopts the Basel III recommendations concerning the NSFR and applies them to the Israeli banking system. It reflects the stance of the Supervisor of Banks on every topic on which the Supervisor has discretion.
3. Banking corporations shall comply with the NSFR while maintaining the liquidity coverage ratio specified in Proper Conduct of Banking Business Directive no. 221 (hereinafter: the LCR Directive) and complying with the qualitative requirements for liquidity-risk management established in Proper Conduct of Banking Business Directive no. 342.
4. After consulting with the Advisory Committee on Banking Business Affairs and with the approval of the Governor, I have established this Directive.

General

5. The NSFR Directive sets a minimum level of stable funding for banking corporations. The Supervisor may instruct a specific banking corporation to maintain a higher NSFR if he believes that said corporation's liquidity-risk profile is not adequately reflected in its NSFR.
6. The section numbering in the Directive resembles that in the Consolidated Basel Framework document of published on December 16, 2019[1] (NSF chapter) with the exception of the Introduction, Scope and Definitions chapter (NSF10).

[1] https://www.bis.org/bcbs/publ/d491.htm

Main provisions of the Directive

7. Introduction and Scope (Sections 1.1–1.8 of the Directive)
   (a) The Directive applies to a banking corporation with the exception of joint service company.
   (b) A banking corporation that heads a banking group shall apply the Directive on a consolidated basis. This notwithstanding, a banking corporation shall also actively monitor and control its NSFR at the level of the individual legal entity.
   (c) A banking group shall recognize surplus available stable funding (ASF) relative to its net stable funding (NSF) only if said surplus is transferable in consideration of various restrictions.
   (d) A branch of a foreign bank shall comply with the conditions in Chapter 5 of this Directive.

Explanatory remarks

This Directive shall be implemented by all banking corporations on a consolidated basis.

For the time being, acquirers need not comply with the Directive and shall continue to meet the requirements of Proper Conduct of Banking Business Directive no. 342. To eliminate doubt, a subsidiary of a banking corporation that is an acquirer shall be taken into account by the banking group in calculating the consolidated NSFR.

8. Definitions (Sections 1.9–1.11)

The definitions of the NSFR are identical to those in the LCR Directive unless noted otherwise. The definition of a "financial institution" is added.

Explanatory remarks

The liquidity coverage ratio (LCR) and the net stable funding ratio (NSFR) are two standards that reflect the condition of a banking corporation in the same area of risk, liquidity; therefore, the definitions are identical irrespective of the time frames that they represent.

9. Calculation and Reporting (Chapter 2)

Banking corporations must maintain an NSFR—total available stable funding divided by total required stable funding—calculated across currencies and no smaller than 100 percent at any given point in time. The NSFR shall be maintained and reported as the total for all currencies together, but banking corporations are also expected to monitor and control the NSFR in each of their main currencies.

The NSFR shall be reported to senior management and the Board of Directors at least once per quarter.

Explanatory remarks

Banking corporations must maintain an NSFR that is equal to or greater than 100 percent on a regular basis. They shall report the ratio at a frequency of no less than once per quarter. In stress or extreme situations, the expected frequency shall increase as circumstances warrant.

10. Available stable funding and required stable funding (Chapter 3, Sections 3.1–3.4)

The approximate extent of stability of liabilities that constitute ASF is based on several characteristics: funding tenor, funding type, and counterparty. ASF sums are calibrated in a manner that reflects the following assumptions: long-term liabilities are more stable than short-term liabilities, and funding from retail and small-business customers is behaviorally more stable than wholesale funding with the same maturity.

RSF is measured on the basis of various characteristics that affect the liquidity-risk profile of the corporation's balance-sheet assets and off-balance-sheet exposures. These characteristics include resilience of credit creation—an assumption as to the share of credit that the corporation will have to extend in order to assure the continued existence of activity in the real economy; the banking corporation's business behavior in regard to the share of loan rollover as part of maintaining customer relations; asset tenor—the assumption that certain short-term assets require a smaller share of stable funding and lower asset quality; and value of liquidity—the assumption that unencumbered high-quality assets that can be used to obtain immediate funding need not be fully funded by means of stable funding.

11. Definition of available stable funding (Chapter 3, Sections 3.5–3.14)

The chapter presents a breakdown of the ASF factors that various liabilities and capital instruments receive. To calculate these factors, all balance-sheet balances of capital and liabilities are assigned to one of the five categories included in the Directive. Each category receives an ASF factor of 0–100 percent. Total ASF is the total of the weighted sums. The main categories follow:

(a) Total regulatory capital before adjustments and deductions, not including Level 2 capital instruments that have residual maturity of less than one year and funding (secured and unsecured) with residual maturity of one year and more, receive a 100% ASF factor.

(b) "Stable" deposits of retail and small-business customers, non-maturity (demand) and time deposits with less than one year of residual maturity, receive a 95% ASF factor.

(c) "Less stable" deposits of retail customers and small-business customers, non-maturity (demand) and time deposits with less than one year of residual maturity, receive a 90% ASF factor.

(d) Funding from nonfinancial wholesale customers, sovereigns, public sector entities, and multilateral and national development banks with less than one year of residual maturity; operational deposits; and other funding, including funding from central banks and financial institutions with residual maturity of six months to less than one year, all receive a 50% ASF factor.

(e) Funding from central banks and financial institutions with less than six months of residual maturity, other liabilities with no stated maturity date, and derivatives liabilities (net of derivatives assets), receive a 0% ASF factor.

Explanatory remarks

The ASF categories are based partly on the definitions in the LCR Directive, thus the allocation of deposits into "stable" and "less stable" retail, small-business, nonfinancial wholesale, operational, and other deposits is based on the definitions in the LCR Directive. In addition, the treatment of retail deposits of legal entities of a banking group abroad shall comply with a principle similar to that set forth in Sections 169 and 170 of the LCR Directive.

Instructions relating to other categories or the way they are calculated are included in the Directive itself, as are instructions concerning the amount of regulatory capital and calculation of the sum of derivatives liabilities. The Directive also includes instructions on how to determine the maturity date of a capital instrument or a liability.

12. Definition of required stable funding for assets and off-balance-sheet exposures (Chapter 3, Sections 3.15–3.34)

The chapter present a breakdown of the required stable funding (RSF) factors that various assets and off-balance-sheet exposures receive. Much like ASF, first all balance-sheet assets of the banking corporation are assigned to the appropriate categories. Each category is given an RSF factor that ranges from 0 to 100 percent. The total RSF is the sum of the weighted amounts plus an additional RSF sum on account of off-balance-sheet exposures. The main categories follow:

(a) Reserves at the Bank of Israel and other central banks (insofar as the regulator at the central bank's location so determines) and central-bank liabilities with residual maturity of less than six months are assigned a 0% RSF factor.

(b) Level 1 unencumbered assets, as defined in the LCR Directive, and off-balance-sheet exposures such as credit and liquidity facilities, are assigned a 5% RSF factor.

(c) Unencumbered loans to financial institutions, secured by Level 1 assets and having residual maturity of less than six months, are assigned a 10% RSF factor.

(d) Unencumbered Level 2A assets as defined in the LCR Directive, and loans to financial institutions with residual maturity of less than six months, are assigned a 15% RSF factor.

(e) Unencumbered Level 2B assets as defined in the LCR Directive, loans to financial institutions and central banks with residual maturity of six months to one year, operational deposits, and all other assets (not included in previous categories) with residual maturity of less than one year are assigned a 50% RSF factor.

(f) Unencumbered housing loans that are secured by a mortgage and qualify for 35 percent risk weighting for capital-adequacy purposes and have residual maturity of one year or more, along with other loans (except those to financial institutions) with up to 35 percent risk weighting for capital-adequacy purposes and residual maturity of one year or more, are assigned a 65% RSF factor.

(g) Assets posted as intial margin for derivatives contracts or posted to the default fund of a central counterparty, other loans (not included in previous categories) not in default and with residual maturity of one year or more, securities with residual maturity of one year or more, and tradable equities are assigned a 85% RSF factor.

(h) Assets encumbered to a term of one year or more, derivatives assets (net of derivatives liabilities), assets with no stated maturity, and all other assets not included in previous categories are assigned a 100% RSF factor.

(i) Additional categories of off-balance-sheet activity on account of guarantees for homebuyers (under the Sale [Apartments] [Assurance of Investments of Persons Acquiring Apartments] Law 5735-1974) are assigned an RSF factor of 1 or 3 percent (contingent on whether the apartment has been handed to the purchaser and on the basis of the provisions in Proper Conduct of Banking Business Directive no. 203).

(j) Other non-contractual obligations receive an RSF factor as determined by the bank on the basis of their characteristics and the likelihood of their realization to a liquidity need that require funding.

In addition, the Directive gives instructions for the treatment of encumbered assets, receivables (and payables) on account of securities-funding transactions, and calculation of derivatives assets.

Explanatory remarks

The classification of assets is also based partly on the definitions in the LCR Directive.

For the time being, the RSF for demand reserves with the Bank of Israel is set at 0%, in line with that set by the Basel committee and by various countries abroad, including the United States and the European Union. In the future, however, a rate other than 0 percent may be set because the Basel Committee allows the Supervisor of Banks to set a different rate in accordance with the agreements between the central bank and the Supervisor of Banks and taking account whether demand for the reserves will be maintained in the long run.

The categories and factors of off-balance-sheet exposures are adjusted to characteristics of this activity in Israel, in accordance with the discretion that Basel allows in this matter.

Assets originatded from or encumbered to exceptional central-bank activity may receive a reduced RSF factor. The Supervisor of Banks shall give notice of this reduced factor and the terms for its implementation insofar as he sees fit to do so.

The Directive also gives guidelines on how to determine the maturity date of assets in order to classify them into the various categories.

13. Interdependent assets and liabilities (Chapter 3, Section 35)

The Supervisor of Banks may, under certain circumstances, recognize the interdependency of certain asset and liability items on a banking corporation's balance sheet. The Directive gives the underlying conditions for the recognition of such an interdependency, which leads to the assignment of 0% RSF and ASF factors for the interdependent items.

Explanatory remarks

The Directive includes the Basel statement on interdependent assets and liabilities. Recognition of interdependency is subject to case-by-case approval of the Supervisor of Banks.

14. **Summary and Issues in Applying the Net Stable Funding Ratio (Chapter 4)**
The chapter summarizes the components of the ASF and RSF categories and the factors that correspond to each category (Tables 1 and 2)
Also included are guidelines for the treatment of three specific instruments: partly secured loans, where each portion has a different risk weighting for capital-adequacy purposes; assets owned by a banking corporation that are separated due to regulatory requirements for the protection of customer assets; and non-operational deposits with financial institutions.

15. **NSFR of a Branch of a Foreign Bank (Chapter 5)**
A branch of a foreign bank with annual average assets less than NIS 15 billion need not comply with and monitor the Net Stable Funding Ratio, provided it complies with the requirements for an exemption from the LCR ratio as specified in Annex 3 of the LCR Directive. If the assets of the foreign branch exceed NIS 15 billion, the Supervisor of Banks shall consider broadening the liquidity requirements and applying the Net Stable Funding Ratio to the branch.

Explanatory remarks

The incidence of the Net Stable Funding Ratio Directive for a branch of a foreign bank shall parallel that of the LCR Directive. A foreign branch that satisfies the requirements in Annex 3 of the LCR Directive (Liquidity Ratio for a Branch of a Foreign Bank and comfort letter from the parent bank) shall be exempt from complying with the liquidity cover ratio and the net stable funding ratio as long as its assets do not exceed the threshold established.

Application

16. The contents of this Circular shall go into effect on December 31, 2021.

File update

17. Update pages for the Proper Conduct of Banking Business Directives file are attached. The following are the update instructions:

Remove page	**Insert page**
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Sincerely,

Yair Avidan
Supervisor of Banks